A KEYNOTE ADDRESS ON THE OCCASION OF THE SEMINAR ON "FOREIGN EXCHANGE MANAGEMENT UNDER THE STRUCTURAL ADJUSTMENT PROGRAMME IN NIGERIA"

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Distinguished Ladies and Gentlemen, it is indeed a rare honour and privilege for me to be invited to be the Chairman of, and to participate in, this Seminar on a most relevant and topical theme, namely, "Foreign Exchange Management under the Structural Adjustment Programme in Nigeria".

I welcome this interface with academia, first, as a student ever willing to learn from the collective wisdom of what must be the most distinguished assemblage of economists in Africa. Second, this occasion affords me a unique opportunity to present an insider's perspective, albeit only in outline. In this connection, I will attempt to clarify issues and explain some developments while challenging the positions taken by some well-known academic economists. Third, it is an occasion for cross-fertilisation of ideas and the resolution of controversies. Fourth, fortified by an awareness of the far-reaching political and economic reforms going on in Eastern Europe and the abandonment of strongly-held ideological positions in those countries, participants at this seminar would be expected to be objective and to discard the ideological fixation which had afflicted the thinking and proposals of many otherwise well-meaning economists. It is, therefore, hoped that at the end of this seminar we would be better informed on the subject and generate sound and credible proposals aimed at consolidating the positive aspects of the new foreign exchange regime while mitigating its adverse effects.

Indeed, this seminar promises to be a landmark and holds out high hopes. For these and the privileges and opportunities offered by the seminar, I am most grateful to the organisers, the Nigerian Economic Society. Moreover, the Nigerian Economic Society must be specially commended for the keen and healthy interest it has consistently taken since its foundation in the developments in the Nigerian economy by organising seminars, workshops and conferences on leading sectors and issues. If some of its communiques and recommendations have turned out to be unrealistic and unworkable it is not for want of intellectual brilliance or rigour; it may well be that its recommendations reflect the different, if not conflicting, orientations and ideologies of its members and that the ideas and ideals, which the most articulate and vocal of them sponsor, lack pragmatism which is the hallmark of political economy. I must resist the temptation to be deliberately provocative although such a stimulus could have the desirable effect of eliciting the best in the participants. I am not, however, prepared for their worst!

Dwelling on the more substantive issues raised by the theme of this seminar it is necessary to proceed by articulating the following elements and issues:

(i) Foreign exchange – concepts, sources, uses, levels and trends.

(ii) The foreign exchange market – structure, participants, operations, pricing mechanism, developments and performance appraisal.

(iii) Exchange rate developments – determinants, levels, trends, and implications for the economy.

(iv) Methodology of determining realistic equilibrium exchange rate.

(v) Issues in Foreign Exchange Management – funding of the foreign exchange market, sectoral allocation of foreign exchange, exchange rate policy, external borrowing policy and debt strategy, diversification policy, optimal deployment, reserve policy, the role of the monetary authorities etc.

Although I have been informed by the organisers of this seminar that five papers on various aspects of the theme are to be delivered by experts drawn from the banking industry and the Universities, I have not been privileged to know the titles of such papers. However, I assume that they will cover all or most of the elements I have outlined above and that they would adequately deal with the issues. Consequently, apart from identifying what I consider to be some of the leading issues in foreign exchange management since the SAP, it would not be appropriate, nor is it my intention, to explore any of them in any detail. I would, however, like to take the opportunity offered by this seminar to share the following thoughts with you.

First, by the time the SAP was introduced in 1986, the country was on the verge of economic collapse. Far-reaching economic reform was, therefore, inevitable.

Second, over two decades in which inappropriate policies and errors held sway, in particular the substantial overvaluation of the naira, stringent trade and exchange regulations the seeds of economic decline and crises had been sowed and germinated. The various policy responses, including the above and the Economic Stabilisation Measures of 1982, were grossly inadequate in dealing with the problems and engendered a number of adverse repercussions such as massive capital flight, low capacity utilisation, supply shortages, long consumer queues for essential commodities and trade and exchange malpractices.

Third, the Foreign Exchange market which was introduced in September, 1986, in its structure, workings, developments and impact, has tended to be largely misunderstood by many commentators. Contrary to the general notion that there is absolute freedom in the market where the naira is left entirely to the forces of supply and demand, the market is a managed one with some measure of freedom. The guidelines for the conduct of the market provide for documentation requirements as a condition for access by buyers of foreign exchange (except in the bureaux de change); supply and demand are largely unresponsive

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to price; there are ceilings on what individual banks can purchase from the official auctions etc. In a market that is largely demand driven, without the above "barriers" to access, the exchange rate emerging would have been well beyond the wildest imagination of critics who argue that the naira has been unduly depreciated. Indeed, the absence of the above residual controls on current transactions would have implied that the naira had achieved full covertibility which of course is an unrealistic proposition.

Fourth, in spite of its shortcomings and imperfections, the (S)FEM since its inception has operated satisfactorily as an allocative system for scarce foreign exchange resources and in achieving a more realistic exchange rate regime. Indeed, the market has enhanced the efficiency of allocation by channelling the bulk of available resources to the productive sectors even without the operation of a mandatory system of sectoral allocation. There has also been a corresponding reduction in waste and malpractices. The unification of rates since January 1989 which has fostered the emergence of a single exchange rate regime in the interbank market is a significant achievement.

Fifth, exchange rate developments (levels and trends) have been a topical issue which had provoked a great deal of interest, concern and controversy since the introduction of the SAP. The main sources of concern and controversy have been the massive depreciation of the naira, exchange rate instability, and the wide divergence between the official funds exchange rates and those of other funds. Happily most of these concerns have become historical or have lost most of their validity in the light of increased exchange rate stability, the substantial reduction in the parallel market premium and perhaps better public understanding of the factors responsible for the depreciation of the naira. Nevertheless, there is still some controversy over what is a realistic exchange rate for the naira. Indeed some concerned académic economists took the occasion of the recent National Workshop on the Economic Recovery Programme organised by UNILAG CONSULT in collaboration with the PRESIDENCY, January 30, 31 and February 1, 1990 to reiterate their concern that the naira exchange rate was grossly undervalued and that it should be pegged at no more than ₦3.50 to $1.00. Consequently, one of the challenges of this seminar is that it should resolve the exchange rate question in an objective and credible way and lay the controversy to rest for good. As my contribution towards the achievement of this objective, I shall now attempt to explain exchange rate developments by making the following clarifying points:–

(a) The exchange rate in a free-market environment is the outcome of the interplay of the market forces of supply and demand. The substantial depreciation of the naira since the advent of the SAP has arisen largely from inadequate supply of foreign exchange relative to demand. Moreover, exchange rate movements (variability) are determined by economic fundamentals namely, balance of payments position; relative inflation and interest rates. Psychological factors, such as expectations, also affect the rate by giving rise to speculative pressures such as the "speculative drift" that was experienced in the last quarter of 1988 and the first half of 1989. All things considered, exchange rate is an index of a country's overall economic performance and policies and since these were largely unsatisfactory prior to the introduction of reform, the greater has been the degree of depreciation required to correct for the past misalignment.

(b) A currency is said to be undervalued if the official rate is lower than the equilibrium rate defined as that rate which makes it identical with its purchasing power parity. And under a price auction model i.e. competitive free market conditions, it is the rate which clears the market. In spite of the limitations imposed by conceptual and measurement problems such as choice of a suitable base year, compilation of consumer price indices for Nigeria and the weighted average inflation rates for Nigeria's trading partners, the studies undertaken by the Central Bank of Nigeria on the optimal exchange rate for the naira using, the purchasing power parity model (PPP) have confirmed that by and large the exchange rates prevailing since the introduction of the (S)FEM have been closer to the PPP path and therefore, more realistic than during the pre-SFEM era. Of course, it is recognised that exchange rate "overshooting" might arise from time to time as a result of the distortions, rigidities and leakages in the economy as well as speculative pressures. The authorities have been quite conscious of such exchange rate "overshooting" and the need for corrective action through monetary and fiscal policy measures.

(c) Those academic economists who have advocated fixing the naira exchange rate at a ceiling of ₦2.50 or ₦3.50 to $1.00 should give an objective basis for their prescription. If they choose to apply the PPP model and have all the relevant data input, and select a suitable base year, they should come out with an exchange rate which is not far off from the prevailing official rate.

(d) Policy makers are conscious of the trade-offs involved in ensuring the emergency of an exchange rate regime which while it aims at reducing import dependence and encouraging non-oil exports also secures an appropriate balance between the needs of importers (i.e. capacity utilisation, domestic price stability) and the needs of exporters and other foreign exchange earners. Securing such a balance in practice is by no means easy; it requires sound judgement and market guidance.

From the above, it is clear that the exchange rate has not been a matter of benign neglect, left to the absolute forces of the market.

To conclude this discussion on the exchange rate, I should leave you with the dictum of Prof. Jacques Polak namely, that "no country has an advantage in sticking to a disequilibrium rate for its currency, and no country in the end manages to do so".

A sixth thought I should like to share with you is that Nigeria's comprehensive programme of rational economic reform is being executed at a time when the country's resources in terms of real domestic savings and foreign exchange have become severely compressed. This "resource gap" is a severe constraint in achieving a growth – oriented structural adjustment and in minimising the social and other costs associated with economic reform. Consequently, the savings/investment rate has to be substantially increased but since this cannot be achieved in the short term at the prevailing low levels of real income, the inflow of external resources in the form of direct capital investment, portfolio investment, concessionary finance from bilateral and multilateral sources becomes highly desirable. In this connection, I should point out that there is nothing wrong per se in external borrowing if such loans are used to finance the growth of the economy, enhance employment opportunities and bring about the greater diversification of the economy. Such external finance which, by our definition, is project-tied would not only be consistent with the "human needs" conditionality for achieving successful adjustment with growth, giving it a "human face" and sustaining the will to adjust, it should ultimately enhance the capacity of the economy to service the debt through future income streams generated from such projects. However, properly considered, external finance should be a supplement to our indigenous efforts. This is why the expansion and diversification of our non-oil exports, enhancement of productivity and development and widespread use of local technology should be seen as matters of top priority because no meaningful restructuring of our economy can take place without them, the inflow of external finance notwithstanding.

Seventh, a major lesson in our efforts at restructuring the economy is that the process is rather complex and that time, patience, persistence, hardwork and sacrifices are called for. The initial euphoria has now given place to greater pragmatism and more sensitivity about the political economy of structural adjustment. Although some structural changes have taken place as evidenced by greater cost consciousness, the inculcation of a maintenance culture, the emergence of consumer sovereignty, the revamping and reintegration of the rural economy, the alteration of the internal terms of trade in favour of the rural sector, the reversal of the phenomenon of rural-urban drift, increased local sourcing, positive changes in the current account balance, a lot more is yet to come, namely economic diversification, reducing import dependence and vulnerability of the economy to external shocks. All things considered, the worst is over, the economy has been reasonably stabilised, recovery has begun and we are in the initial stages of the resumption of growth.

Eighth, while it is acknowledged that there are constraints and shortcomings under the existing arrangements, it is my contention that there is no other viable and credible alternative to the on-going structural adjustment. Consequently, it is a matter for concern that some critics instead of calling for an improvement in the existing arrangements are proposing measures or modifications which had been tried before and found to be unworkable and were in fact largely responsible for the malaise of the economy in the past. Such proposals should be rejected both on the above grounds and on the grounds that such policy reversal would be a fatal volte face. We should accept that the days of trade and exchange controls including fixed exchange rates are gone and those who advocate a return to the status quo are out of touch with present realities. Again, this is not to indicate that we are operating a perfect system which cannot be improved. I accept that within the basic policy framework of the SAP, there is more that could be done to achieve both the objectives of SAP more significantly and the mitigation of the adverse repercussions associated with its implementation.

I should now like to conclude this short address by raising some methodological issues and posing challenges for our academic economists.

(i) The real world of business and public policy in Nigeria is a rather complex one and text-book models provide at best very limited guidance. Indeed, the Nigerian variant of structural adjustment has had so many unique features and innovations added to it that it is indeed a set of practical arrangements in need of a theory. I have already referred to exchange rate determination and proposed the PPP model as a basis for determining the equilibrium rate. Here, the world of the foreign exchange market is in reality more random than the macro-econometric models constructed by some academic economists tend to indicate. Consequently, the models lag behind reality. Sound judgement and schema that are more oriented to problem solving and decision-making are called for.

(ii) There is the optimisation criterion which is the foundation of microeconomic theory. However, as Simon and March have since argued, "finding the optimal alternative is a radically different problem from finding a satisfactory alternative". Consequently, in the real world of business and macroeconomic management the concern of economists and policy makers should be with the discovery and selection of satisfactory alternatives and "optimising" is replaced by "satisfying". I contend that even in the developed economies with sophisticated decision making aids and formidable forecasting models, only by fluke does monetary policy or fiscal policy become optimal. Economists should therefore focus on targets or levels of satisfactory results than talk glibly about optimal results which are ideal world constructs.

(iii) Developments in the Nigerian economy, especially in the foreign exchange market, since the introduction of the SAP should provide areas for rewarding research by economists in terms of the useful practical insights which such studies would generate. Some of these interesting areas are the interrelationships among variables such as interest rate, exchange rate, inflation rate and the channels of causation. For instance, is interest rate an effective anti-inflation strategy and if so has it any limitations in terms of possible cost-push implications? There is also the need to return to the micro-economic foundations of the discipline in order to understand the functioning of markets under varying degrees of imperfection and phenomena such as speculation, hedging, oligopoly and collusion. Furthermore, with the critical role of productivity growth in our anti-inflation strategy, productivity studies should be a matter of interest to economists.

(iv) There is the issue of review of SAP policy measures and assessment of their impact. There is need for greater sophistication in the methodology of assessment of SAP to ensure objectivity and fairness. In this connection, there are a number of approaches in assessing performance:

(a) assessing the programme in terms of its stated objectives and targets i.e. relating actual to projected performance;

(b) comparing actual performance during the pre-SAP period with the performance following the introduction of the programme; and

(c) comparing what was achieved to what would have happened if the programme was not introduced.

Although the first two criteria appear logical they are defective and could lead to misleading conclusions. This is because targets are estimates and there is nothing sacrosanct about them; targets may not be achieved either because they were overly ambitious or the underlying assumptions about the resource profile and the responsiveness of the economy turn out to be unrealised especially in a very dynamic environment of market volatility and external sector fragility. Consequently, I submit that the third criterion, although conjectural is the most meaningful and fair.

It is perhaps pertinent to report that as part of the efforts to ensure more fact-based performance appraisals, the Central Bank in collaboration with NISER is currently carrying out a country-wide field study on the impact of the SAP on the agricultural sector.

(v) What role should economists play in shaping public policy in Nigeria and what has been their influence? Although I recognise that there are economists in Government, this question is addressed specifically to academic economists. I submit that given their large number and formidable credentials, the time available to them for research and reflection on the economy, they do have an important role to play in shaping public policy. I further submit that their relevance and credibility would be enhanced if they are uncompromising in adhering to scientific truth. and have a good working knowledge of, and are properly aligned with, the real world environment in which they operate such that they come out with practicable and workable proposals for the solution of societal problems.

In this connection it is a matter for serious regret to note that some Nigerian economists, even after perestroika and glassnost, and the revolutionary economic and political reforms taking place in Eastern Europe, still stick rigidly and quixotically to theories and practices of political economy which have since been discredited and discarded. But I recognise that there are many in the profession who have consistently adhered to high standards of intellectual honesty and objectivity in the best traditions of economic science and at the same time are responsive to both the intellectual ferment and political and economic changes going on around them. For such protagonists of scientific truth they should take solace in the recognition that, in the words of Ludwig Von Mises, "The criterion of truth is that it works even if nobody is prepared to acknowledge it".

On this positive note, I rest my case and now take my seat as a moderator and umpire in the proceedings that are now about to unfold with our distinguished academic economists taking their most deserved centre stage.